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## WISCONSIN LEGISLATIVE COUNCIL AMENDMENT MEMO

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<b>2015 Senate Bill 503</b>	<b>Senate Substitute Amendment 1 and Senate Amendment 1 to Senate Substitute Amendment 1</b>
<i>Memo published: February 12, 2016</i>	<i>Contact: Zach Ramirez, Staff Attorney, (267-9485)</i>

2015 Senate Bill 503 (the bill) generally makes changes to current law relating to: (1) transactions without economic substance; (2) construction contracts; (3) the manufacturing and agriculture tax credit; (4) rule-making by the Department of Revenue (DOR); (5) failure to produce records; (6) reliance on past audits; and (7) the Multistate Tax Commission Audit Program.

Senate Substitute Amendment 1 (the substitute amendment) removes the bill's provisions relating to the manufacturing and agriculture tax credit, rule-making by DOR, and reliance on past audits.

Under the substitute amendment, changes would be made to current law regarding transactions without economic substance, construction contracts, failure to produce records, and the Multistate Tax Commission Audit Program.

Senate Amendment 1 to Senate Substitute Amendment 1 changes the provisions in the substitute amendment relating to construction contracts.

### TRANSACTIONS WITHOUT ECONOMIC SUBSTANCE

#### Current Law

Under current law, if a person engages in a transaction without economic substance to create a loss or to reduce taxable income, or to increase credits allowed in determining Wisconsin tax, DOR must disregard the transaction when it determines the amount of the taxpayer's taxable income or tax. A transaction has "economic substance" only if the taxpayer demonstrates all of the following:

- The transaction changes the taxpayer's economic position in a meaningful way, apart from federal, state, local, and foreign tax effects.

- The taxpayer has a substantial nontax purpose<sup>1</sup> for entering into the transaction and the transaction is a reasonable means of accomplishing the substantial nontax purpose.

### **Senate Substitute Amendment 1**

The substitute amendment repeals the two current law criteria that determine economic substance, described in the bullet points above. The substitute amendment provides that a transaction has “economic substance” only if the transaction is treated as having economic substance under the Internal Revenue Code, considering federal, state, local, or foreign taxes.

## **CONSTRUCTION CONTRACTS**

### **Current Law**

Current law provides a tax exemption, for purposes of sales and use taxes, for property, items, and services that are sold by a contractor as part of a lump sum contract,<sup>2</sup> if the total sales price of all such taxable products is less than 10% of the total amount of the lump sum contract. The contractor is the consumer of such taxable products and must pay the sales and use tax imposed on the products. If the lump sum contract is entered into with an entity that is exempt from taxation (such as the state or a municipality), the contractor may purchase without tax, for resale, property, items, and services that are sold by the contractor as part of the lump sum contract with the entity and that are not consumed by the contractor in real property construction activities.

### **Senate Substitute Amendment 1**

The substitute amendment provides that the tax exemption applies to products<sup>3</sup> and applies to any construction contract,<sup>4</sup> not only lump sum contracts. Specifically, the bill provides a tax exemption, for purposes of sales and use taxes, for products that are sold by a prime contractor as part of a construction contract, if the total sales price of all products is less than 10% of the total amount of the construction contract. Under this exemption, the prime contractor is the consumer of the products and must pay the sales and use tax imposed on the products.

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<sup>1</sup> Under current law, a transaction has a “substantial nontax purpose” if it has substantial potential for profit, disregarding any tax effects.

<sup>2</sup> Under current law, “lump sum contract” means a contract to perform real property construction activities and to provide property, item, and services as one price, including a contract for which the contractor itemizes the charges for labor, subcontractor services, property, items, and services as part of a schedule of values or similar document.

<sup>3</sup> Under current law, “product” includes tangible personal property, and items, property, and goods under s.77.52 (1) (b), (c) and (d), Stats., and services.

<sup>4</sup> Under the substitute amendment, “construction contract” means a contract to perform real property construction activities and to provide construction materials.

In addition, the substitute amendment provides a tax exemption, for purposes of sales and use taxes, for products that are sold by a subcontractor to a prime contractor or another subcontractor as part of a construction contract, if any of the following applies: (1) the sales price is exempted under the prime contractor tax exemption for the products resold by the prime contractor; or (2) the sales price is less than 10% of the total amount of the construction contract. Under this exemption, the subcontractor is the consumer of the products and must pay the sales and use tax imposed on products.

The substitute amendment also provides that if a construction contract is between a prime contractor and an entity that is exempt from taxation (such as the state or a municipality), the subcontractor of the prime contractor may purchase without tax, for resale, products that are sold by the subcontractor to the prime contractor or another subcontractor, as part of the subcontractor's contract, for resale to the entity and that are not consumed by the subcontractor in real property construction activities.

The substitute amendment provides that the provisions relating to construction contracts first apply to a contract entered into or extended, modified, or renewed on the day after publication of the bill.

#### **Senate Amendment 1 to Senate Substitute Amendment 1**

Senate Amendment 1 to Senate Substitute Amendment 1 changes the provisions in the substitute amendment relating to a tax exemption, for purposes of sales and use taxes, for products that are sold by a subcontractor.

Under Senate Amendment 1 to Senate Substitute Amendment 1, a sales and use tax exemption is provided for products that are sold by a subcontractor to a prime contractor or another subcontractor **for eventual sale to the prime contractor**, as part of a construction contract, if any of the following applies: (1) the **total sales price of all products** is less than 10% of the total amount of the construction contract; or (2) the products will be sold by the prime contractor as part of a construction contract and that sale is exempt under the prime contractor tax exemption provided in the substitute amendment.

Senate Amendment 1 to Senate Substitute Amendment 1 also delays the application of all provisions relating to construction contracts by providing that they first apply to a contract entered into or extended, modified, or renewed on January 1, 2017.

#### **FAILURE TO PRODUCE RECORDS**

##### **Current Law**

Current law provides that a person who fails to produce records or documents that support amounts or other information on a tax return is subject to certain penalties.

### **Senate Substitute Amendment 1**

Under the substitute amendment, to be subject to penalties provided under current law, a person must also fail to comply in good faith with a summons issued by DOR seeking the records or documents. The substitute amendment provides that these provisions first apply to an audit commenced, or a summons issued, on the effective date of the provisions.

### **THE MULTISTATE TAX COMMISSION AUDIT PROGRAM**

#### **Current Law**

Under current law, DOR has authority to enter into a contract to participate in the Multistate Tax Commission Audit Program.

### **Senate Substitute Amendment 1**

The substitute amendment repeals DOR's authority to participate in the Multistate Tax Commission Audit Program. Under the substitute amendment, the repeal first applies to a contract entered into or extended, modified, or renewed on July 1, 2017.

### **BILL HISTORY**

Senator Marklein offered Senate Substitute Amendment 1 on January 27, 2016. On February 2, 2016, Senator Marklein offered Senate Amendment 1 to Senate Substitute Amendment 1.

On February 8, 2016, the Senate Committee on Revenue, Financial Institutions, and Rural Issues recommended adoption of Senate Amendment 1 to Senate Substitute Amendment 1, on a vote of Ayes, 5; Noes, 0. On the same day, the committee recommended adoption of Senate Substitute Amendment 1, as amended, and passage of the bill, as recommended, on votes of Ayes, 3; Noes, 2.

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